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UNIFORM
Cost Methods

AN ADDRESS
BEFORE THE
PACKAGE CLUB

APRIL 12, 1915

By CHAS. NEVILLE, C. P. A.

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CHAS. NEVILLE & CO.
CERTIFIED PUBLIC ACCOUNTANTS
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By CHAS. NEVILLE, C. P. A.

Of Chas. Neville & Co., Certified Public Accountants
Savannah and Jacksonville

GENTLEMEN:—

Your committee was kind enough to ask me to tell you something about our experience with Costs. To meet this kind invitation, I will endeavor to bring out some interesting points of our work, and discuss the necessity of knowing COSTS.

It is only within the past few years that Cost finding has made rapid strides, and it is admitted that the greatest benefit in various lines of business has come from association of people in the same trade. If you have anything good in your business, give it to your competitor and he in turn will impart to you something of value.

Our practice carries us into many and varied lines of industry, and our experience satisfies us that the most successful business men are those who analyze and know their costs.

To make a profit on desirable commodities sold at competitive prices means the exercise of economy in production, and demands that your expenses be maintained at low water mark. The maintenance of profit on a sound basis or the increase of profit can be assured by unceasing watchfulness only and the minute scrutiny of divided items of cost.

It is not of very great assistance merely to know that your packages cost more than need be. Before the cost of same can be safely reduced, intelligent analysis is necessary to demonstrate to you that reduction in cost will not reduce output.

During the past ten or twelve years business has developed on entirely new lines. Formerly the business man's creed was "each man for himself and the devil take the hindmost," while now co-operation is recognized as a necessity.

In different lines of trade, the necessity of competitors *GETTING TOGETHER* is *more and more* recognized. What is meant by *GETTING TOGETHER* is of course not an attempt to regulate prices or output, but to effect economies by reducing waste, and elimination of duplication of effort. For example,—It follows that when you sell goods out of your territory, that you reduce your profits by the excessive expense of delivering to that point, or that you are able to successfully produce an article cheaper than your competitors.

If the freight is absorbed by you, it means the lessening of your profits, and if you are producing cheaper than your competitor, you are successful through his lack of knowledge of business, which lack of knowledge may in turn make him a dangerous competitor by his selling below production cost in the territory where you are entitled to business.

Consequently, it is essential that crate manufacturers who are engaged in the same line of trade should know their costs. The best way to do this is to have standard accounting methods. I advise regular meetings, to discuss freely the complex problems of material interest that arise in your endeavor to do away with waste, and by *GETTING TOGETHER* eliminate as far as possible this menace to all.

By waste I do not mean merely the loss caused by improper use of material, as for instance the use of one-inch boards where *seven-eighths inches* will do, but other harmful leaks through incompetent labor, wasteful advertising, poor salesmanship, excessive rebates, etc.

There came recently within the speaker's knowledge the successful activities of a selling organization, which annually

disposed of many million brick for ten or fifteen manufacturers. This selling organization was able to accomplish what manufacturers could not do individually—such as delivering from the cheapest point, eliminating credit abuses, etc.

During the past few years, Harvard University has established a bureau of Business Research under the direction of Selden O. Martin, Esq., charged with the duty of securing of precise and reliable information about business. It is a big subject, and in my opinion, of much greater importance to the community than the teaching of dead languages. The conception of this idea is in itself a tribute to the fact that our entire country is awakened to the necessity of knowing the REASON WHY.

It has been conceded that research of this kind must be undertaken by disinterested people, and that such information must be accurate and free from bias. I think it is a high testimonial to the retail business men of this country that they are willing to give the information which makes possible the thoughts expressed in this address.

It was recognized by Harvard University that business has two distinct functions,—one the making, the other the buying and selling. The other activities of business banking and accounting, though necessary, are of secondary importance. Without the first, the other functions have absolutely no importance.

After considerable thought, it was decided to inquire into such functions of retail merchandizing as are country wide; varied yet reflecting generally retail business conditions.

The University decided to investigate first the retail shoe business. By this was meant inquiry into purchasing and selling shoes at retail, and the expenses incidental thereto. By expenses were meant not only the cost of merchandize and freight, but rent, selling, delivery, interest, etc. It is most surprising to see the diversity of profit made on what are considered staple articles of merchandize not subject to violent fluctuations.

Now, this comparison of profit and expense, which will be discussed later, was not secured simply by writing to retail shoe dealers throughout the country and asking them

for facts and figures from their books. It was recognized that the first necessity was a uniform system of accounting, so that the comparisons, as made, would relate to similar conditions and be capable of analysis. This fact is important in any line of business, and you gentlemen, in manufacturing boxes, baskets, etc., must have uniform accounting systems before you can make intelligent comparisons and effect economies, thereby doing away with waste. Accordingly, in 1911, Harvard University through its Bureau of Business Research devised a preliminary system of uniform accounting for shoe retailers.

For three years the Bureau gathered information from six hundred and fifty retail stores located in twenty-six States and Canada, whose accounting systems were uniform and comparable.

While the merchandizing of shoes does not admit of comparisons with your manufacture, the wide divergence of gross profits and expenses in this line of trade has brought out in this investigation ideas of interest to all business men, and emphatically demonstrates the necessity of uniform accounting methods, so as to make comparisons readily available and secure the needed economies and elimination of waste. For example,—The lowest percentage of gross profit in the retail shoe business was 20% and the highest 42%. Naturally local conditions may effect and explain to some extent the low percentage of profit, but such a wide divergence called for investigation, and hence the need of accounting analysis, for if 20% was right, 42% was abnormal.

The disparity of operating expenses was equally interesting. As evidence 18% was the minimum of expenses and 35% was the maximum, and I have no doubt that if your accounting systems were uniform, similarly large discrepancies would be brought out by accurate intelligent investigation, and economies could then be made that would greatly increase your profits.

An item of expense that showed wide variation was rent, which ranged from 1.8 to 14.6%.

I have seen figures from different manufacturing industries which showed a very large variation. As an example,

an investigation of the profits of the Western Stove Manufacturers varied from .87 to 27.6 on the capital invested, with the average less than 6%.

The manufacturer who secured the highest margin of profit knew his costs and refused to sell at less than 10% profit on sales.

The investigation of the American Woolen and Worsted Manufacturers showed a return on the capital invested of only 4.2 for the woolen and 5.5 for the worsted.

The prices on standard cloths sent out for estimates varied over 85% from the highest to the lowest.

This information caused such a furore in the industry that at the meeting of the Association in New York, including almost the entire trade, it was unanimously decided to lay out uniform cost methods. (I am indebted to Messrs. Miller Franklin & Co. for these figures).

The dominant thought brought out by these investigations leads to the conclusion that manufacturers are successful through accurate knowledge and interchange of ideas.

The question may be asked "Does a cost system for a crate manufacturer mean a large increase in your clerical expense?" I am glad to answer this in the negative and to tell you that an accurate uniform cost system in your industry can be handled in your office through instruction by competent people without appreciably increasing your expense.

I have been employed by crate manufacturers to install cost systems. The results of the work of our system have been, I know, profitable to our clients, for it has enabled them to find their costs, and this invariably results in increased profits. I do not feel that any manufacturer should be satisfied unless he knows unit costs.

The merchant in purchasing his goods knows this cost and can consequently figure his gross profits, but the crate manufacturer starting out with a tree in a forest, and working it up into a manufactured product, cannot, without the aid of accounting, tell much about his gross profit.

I have had considerable experience with lumber manufacturers, (and in this category I include crate manufactur-

ers) and it is remarkable to me how few of you appreciate accounting methods which, when properly employed, point out excessive expenses and preventable losses.

Many people believe that System is another name for RED TAPE, but this is far from true, and an accounting system to be really good must be understandable and workable. I do not for one moment claim that it will run itself, or that there is no work involved in a proper system of accounting, but I unhesitatingly say that the benefits and satisfaction derived from knowing your financial condition and earning power monthly more than offsets the extra labor involved in the office.

There are numerous trade organizations that have adopted uniform systems of accounting, and the unanimous opinion of these people is that their earning power has been increased. This does not mean that prices have been increased, but that by accurate knowledge their costs have been reduced and there has been greater stability in selling prices. Within my own knowledge the following lines of trade have adopted uniform standard of accounting which, as said before, have proved beneficial:

Iron Founders,	Carriage Builders,
Tool Builders,	Brass Founders,
Table Manufacturers,	Woolen Manufacturers.

The Government has recognized the necessity of uniformity in accounting by insisting upon the railroads adopting standard methods, for in no other way could railroads compare results. More recently the Government has issued uniform accounting instructions applicable to telephone and express companies.

If you expect to know manufacturing costs it will be obligatory for you to record through your books the depletion of your timber, labor costs, supplies used (which include nails, wire, etc.), repairs to machinery, depreciation of plant and machinery, obsolescence of machinery, also interest on investment.

It will be found that you cannot rely implicitly upon your woodman's report, which shows amount of timber cut, and the information received from the woodsman must be sup-

plemented by independent reports showing what timber is left uncut, otherwise you may not charge expenses with the actual cost of timber used.

Labor costs vary considerably, some of which variance must be attributed to management, but a careful study through accounting of plant conditions will show at times where useless labor may be eliminated by the re-arrangement of your output, so that the product moves forward with the least amount of re-handling, as each unnecessary re-handling involves extra labor costs.

A store-room should be established at some central point, convenient as possible to all departments, and all supplies as received charged to store-room account—keeping a supply ledger in the store-room—and supplies issued only by requisition so that the amount used each month may be charged against that month's manufacture.

Where this has been adopted, it has resulted in a large saving in the purchase of supplies, and with a proper purchase system, whereby the buying is centralized and the purchase power placed under a responsible head, you will buy cheaper and it will largely do away with the probability of supplies running out, thereby retarding your manufacture.

Repairs to machinery and depreciation to machinery occupy a very close relation, but it must not be considered that because repairs to machinery are made as needed that depreciation has no existence.

There is a constant and heavy depreciation in saw mill machinery despite maintenance and repairs. Consequently, to correctly present each month's business, your expenses must include a depreciation charge, the total of which will ultimately amount to the cost of your machinery, less the salvage value of your discarded machines.

I have found that in saw mills and woodworking plants there is little or no salvage value from the plant and machinery when once the timber, contiguous to the plant, is exhausted. Therefore the depreciation must be liberal enough to provide for this loss, for to adopt the other extreme will tend to overstate your profits and result in a loss to the stockholders in the ultimate liquidation.

It is a debatable question among accountants as to how interest on investments should be treated in arriving at the profits of the business. I am not however, in this brief address attempting to go into this question, except to say that the investment made in your business cannot be considered successful unless the stockholders receive in liquidation the money put into the business and at least a reasonable return in the way of dividends which, after all represents interest on money invested in the business. Neither have I attempted to tell you how to run your books, but if in this talk I have succeeded in convincing you of the necessity of providing a comprehensive accounting I will feel that I have been amply repaid.

If engaged to install a standardized system of accounts for crate manufacturers, by means of which intelligent comparisons of output and costs could be made, I would particularly emphasize the necessity of monthly closing of the books, and the taking at the same time of inventories.

Many concerns think it a good practice to close their books only once a year, and yet the same concerns who do this would not accept a suggestion from an accountant to balance their cash only annually. Therefore, if cash should be balanced at frequent intervals, the same rule should apply to your merchandise which is only cash in another form.

Our work gives us contact with many lines of business, successful and otherwise, and I find that the majority of successful concerns are those who use accounting to analyze their business, and by means of this analysis, increase their effectiveness.

I should now be very glad to answer any questions which any of you care to ask in this connection—and I thank you for your attention.